

CHAPTER 5:

U.S. Relations With Major Trading Partners

This chapter reviews bilateral trade relations and selected trade issues with eight major U.S. trading partners during 2003: the European Union (EU), Canada, Mexico, Japan, China, Taiwan, Korea, and Brazil. Appendix tables A-16 through A-24 provide detailed information on U.S. trade with these partners.

European Union

The United States and the EU share the largest two-way (exports plus imports) trade relationship in the world and are each other's largest trading partners. In 2003, U.S.-EU trade totaled \$380 billion, a 6.8-percent increase over 2002. U.S. exports to the EU increased to \$138 billion in 2003, up by 4.2 percent from 2002. U.S. imports from the EU increased by 8.3 percent in 2003 to \$242 billion, resulting in a \$104 billion trade deficit with the EU in 2003. Leading U.S. exports to the EU during the year included aircraft and aircraft parts, parts of automated data processing machines, and certain medicaments. Leading U.S. imports from the EU included passenger cars, certain medicaments, and nucleic acids and their salts. U.S.-EU trade data are shown in appendix tables A-16 through A-18.

During 2003, two important long-term trade disputes remained on the U.S.-EU trade agenda and were still unresolved at the end of the year. In potentially the largest U.S.-EU dispute in terms of the amount of trade affected, the WTO dispute-settlement process continued during the year in response to an EU complaint¹ that U.S. special tax treatment of foreign sales corporations (FSCs), and the replacement U.S. tax policy (FSC Repeal and Extraterritorial Income Exclusion Act of 2000),² constitute a prohibited export subsidy. Also in 2003, the United States requested the WTO examine the EU's de facto moratorium on approvals of agricultural biotechnology products. Both of these issues are discussed below.

¹ The European Communities (EC) were subsumed into the EU in 1993. Although the complaint was technically filed by the EC, the term EU is used to describe events since 1993.

² Pub. L. 106-519.

Foreign Sales Corporations

Background³

On July 1, 1998, the EU challenged in the WTO the first of two successive U.S. tax regimes.⁴ In both cases, the WTO dispute-settlement panel and Appellate Body found the regime constituted a prohibited export subsidy and was inconsistent with U.S. WTO obligations. Following the second ruling in January 2002, the EU requested WTO authorization to impose \$4.043 billion in tariffs on U.S. products as compensation. On August 30, 2002, the WTO arbitrator circulated its decision that the countermeasures sought by the EU were appropriate, and authorized the EU to impose up to 100 percent ad valorem duties on imports of certain goods from the United States to a maximum amount of \$4.043 billion per year.⁵ On September 13, 2002, the EU published a notice in its Official Journal requesting public comments on a proposed list of U.S. products that could be subject to the countermeasures.⁶

Developments During 2003

On February 26, 2003, following the public consultation procedure that began in September 2002, the European Commission presented member states with a draft list of U.S. products that could be subject to countermeasures.⁷ After a few changes, member states approved the list and the European Commission notified the final version to the WTO.⁸ The list covers over 1,600 products, including certain precious stones and metals, articles of jewelry, fruits, vegetables, sugar, wood products, paper and paperboard, textiles, apparel, footwear, articles of leather, glassware, articles of iron and steel, electrical and non-electrical machinery, and toys and sports equipment. According to the European Commission, to minimize the impact of any countermeasures on EU industry, the list only includes products for which imports from the United States account for less than 20 percent of total EU imports of a specific product.⁹

³ For more information on the background of the FSC dispute, see USITC, *The Year in Trade: OTAP, 2002*, USITC publication 3630, pp. 5-2 to 5-4; USITC, *The Year in Trade: OTAP, 2001*, USITC publication 3510, pp. 4-10 to 4-11; and USITC, *The Year in Trade: OTAP, 2000*, USITC publication 3428, pp. 4-12 to 4-13.

⁴ The two successive tax regimes were (1) the FSC provisions of U.S. tax law, and (2) its replacement, the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (ETI Act).

⁵ WTO, "United States—Tax Treatment for Foreign Sales Corporations," Recourse to Arbitration by the United States, Decision of the Arbitrator," WT/DS108/ARB, Aug. 30, 2002.

⁶ "Notice relating to the WTO Dispute Settlement proceeding concerning the United States tax treatment of Foreign Sales Corporations (FSC)—Invitation for comments on the list of products that could be subject to countermeasures," *Official Journal of the European Communities* (OJ), No. C 217/2 (Sept. 13, 2002).

⁷ European Commission, "Foreign Sales Corporations: European Commission Submits to Member States Draft List of Products That Could be Subject to Countermeasures," press release IP/03/285, Feb. 26, 2003.

⁸ For the definitive list of products, see WTO, "United States—Tax Treatment for Foreign Sales Corporations," Recourse by the European Communities to Article 4.10 of the SCM Agreement and Article 22.7 of the DSU," WT/DS108/26, Apr. 25, 2003.

⁹ European Commission, "Foreign Sales Corporations: European Commission Submits to Member States Draft List of Products That Could be Subject to Countermeasures," press release IP/03/285, Feb. 26, 2003.

On May 7, 2003, the WTO Dispute Settlement Body (DSB) authorized the EU to take appropriate countermeasures and to suspend concessions in the amount of \$4.043 billion per year, in line with the arbitration report issued in August 2002.¹⁰ However, the EU indicated in the DSB meeting that it would give the United States “a short additional period” to make the legislative changes necessary to comply.¹¹ Following the decision of the DSB, the European Commission stated that it expected the United States to ensure compliance with WTO rules before the beginning of 2004.¹² According to Pascal Lamy, EU Trade Commissioner, “The Commission will review the situation in the autumn, and if there is no sign that compliance is on the way at that time, it would then start the legislative procedure for the adoption of countermeasures by January 1, 2004.”¹³

Throughout the year, both houses of Congress continued to work on legislation to address the issue. On October 1, 2003, the Senate Committee on Finance approved legislation (S. 1637, Jumpstart Our Business Strength (JOBS) Act) to repeal the ETI.¹⁴ On October 28, 2003, the House Committee on Ways and Means approved H.R. 2896, the American Jobs Creation Act of 2003, to repeal the ETI.¹⁵ In addition, the administration continued to urge action by the Congress to enact legislation that would bring U.S. law into conformity with the WTO ruling.¹⁶

On December 8, 2003, the EU Council of Foreign Affairs Ministers adopted a regulation to impose countermeasures on U.S. products, beginning on March 1, 2004, if the United States has not yet complied with the WTO ruling.¹⁷ The regulation calls for imposing tariffs of 5 percent on U.S. products on March 1, 2004, with the tariff rate rising by 1 percentage point per month thereafter until a 17-percent tariff rate is reached on March 1, 2005.¹⁸ The European Commission indicated that it will consider

¹⁰ WTO, *News*, “Dispute Settlement Body 7 May 2003, EU Granted Permission to Apply US\$4 Billion Sanctions Against US in Foreign Sales Corporation Case but Delays Application,” May 7, 2003, found at http://www.wto.org/english/news_e/news03_e/dsb_7May03_e.htm, retrieved May 9, 2003.

¹¹ *Ibid.*

¹² European Commission, “Foreign Sales Corporations: Following WTO Authorisation to Apply Countermeasures of Up to \$4 Billion, EU Expects U.S. to Ensure Compliance With WTO Rules Before the Beginning of Next Year,” press release IP/03/642, May 7, 2003.

¹³ *Ibid.*

¹⁴ Senate Committee on Finance, “Grassley Wins Committee Approval of Tax Cut for Manufacturers, Farmers, Significant International Tax Reforms,” press release, Oct. 1, 2003, found at <http://www.senate.gov/~finance/press/Gpress/2003/prg100103.pdf>, retrieved Feb. 17, 2004.

¹⁵ Committee on Ways and Means, “Help for American Workers: Job Creation and Protection,” press release, Oct. 28, 2003, found at <http://waysandmeans.house.gov/news.asp>, retrieved Feb. 17, 2004.

¹⁶ For example, U.S. Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2005 Revenue Proposals*, February 2004, pp. 187-89, found at <http://www.treas.gov/offices/tax-policy/library/bluebk04.pdf>, retrieved Feb. 17, 2004.

¹⁷ Council Regulation (EC) No 2193/2003 of 8 December 2003 Establishing Additional Customs Duties on Imports of Certain Products Originating in the United States of America, OJ No. L 328 (Dec. 17, 2003).

¹⁸ On March 1, 2004, the EU began to impose 5-percent tariffs on U.S. products, as planned. On May 1, 2004, the EU tariffs will also apply to U.S. products exported to the 10 new EU member states.

further action in light of developments at that time.¹⁹ The U.S. Department of Commerce estimates that if countermeasures are imposed on U.S. products from March 1, 2004 through March 31, 2005, the EU would collect additional duties valued at over \$475 million.²⁰

Agricultural Biotechnology

In 2003, there were developments in two issues related to agricultural biotechnology. In May, the United States initiated dispute-settlement proceedings in the WTO to challenge the EU's de facto moratorium on approvals of genetically modified crops and food products. According to the USTR, the EU's de facto moratorium has hurt U.S. exports of corn and threatens to disrupt U.S. exports of soybeans.²¹ In a separate issue related to biotechnology, U.S. exporters expect new EU rules on traceability and labeling to be "onerous and expensive for producers and foreign suppliers to meet."²²

EU Moratorium

Background

Since October 1998, the EU has applied a moratorium on new approvals of agricultural biotechnology products (biotech products).²³ In addition, since the late 1990s, six EU member states—including Austria, France, Germany, Greece, Italy, and Luxembourg—have banned certain varieties of biotech corn and rapeseed already approved by the EU.²⁴ As a result, according to USDA, U.S. exports of agricultural and food products are increasingly being excluded from the EU market,²⁵ and the ban

¹⁹ Council Regulation (EC) No 2193/2003 of 8 December 2003 Establishing Additional Customs Duties on Imports of Certain Products Originating in the United States of America, OJ No. L 328 (Dec. 17, 2003).

²⁰ U.S. Department of Commerce, International Trade Administration, "ITA's Key Links: European Union (EU) Trade Sanctions Against the United States Resulting from the Foreign Sales Corporation/Extraterritorial Income (FSC/ETI) Dispute in the World Trade Organization (WTO)," found at http://www.ita.doc.gov/eu_030104.html, retrieved Mar. 3, 2004.

²¹ USTR, *2004 National Trade Estimate Report of Foreign Trade Barriers*, 2004, p. 142.

²² Ibid.

²³ U.S. Department of Agriculture (USDA), "Five Years of U.S. Patience, Five Years of European Delays," Fact Sheet, found at <http://www.usda.gov/news/releases/2003/05/fs40156.htm>, retrieved Oct. 16, 2003.

²⁴ Ibid. Also see, WTO, *European Communities—Measures Affecting the Approval and Marketing of Biotech Products*, "Request for Consultations by the United States," WT/DS291/1, G/L/627, G/SPS/GEN/397, G/AG/GEN/60, G/TBT/D/28, May 20, 2003, Annex II.

²⁵ USDA, "U.S. and Cooperating Countries File WTO Case Against EU Moratorium On Biotech Foods and Crops," press release, May 13, 2003; and WTO, *European Communities—Measures Affecting the Approval and Marketing of Biotech Products*, "Request for the Establishment of a Panel by the United States," WT/DS291/23, Aug. 8, 2003.

"effectively prohibits most U.S. corn exports to Europe."²⁶ The U.S. Government estimates the lost corn sales alone at several hundred million dollars a year.²⁷

Furthermore, the United States is concerned about the possible "ripple" effects of the EU decision to ban biotech products.²⁸ According to Ambassador Zoellick, "biotech food helps nourish the world's hungry population, offers tremendous opportunities for better health and nutrition, and protects the environment by reducing soil erosion and pesticide use."²⁹ However, the "EU moratorium has sent a devastating signal to developing countries....," some of which have refused U.S. food aid, or have limited biotech plantings due to concerns that their exports to the EU would suffer.³⁰ According to Secretary of Agriculture Veneman, "the EU actions threaten to deny the full development of a technology that holds enormous potential benefits to both producers and consumers worldwide...."³¹

Developments during 2003

On May 13, 2003, the United States requested consultations with the EU to address the biotech moratorium, the first step in the WTO dispute-settlement process. Canada and Argentina also requested WTO consultations with the EU. The United States claims that the biotech moratorium and the national marketing and import bans maintained by the EU member states are inconsistent with the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement), the General Agreement on Tariffs and Trade 1994 (GATT 1994), the Agreement on Agriculture (Agriculture Agreement), and the Agreement on Technical Barriers to Trade (TBT Agreement).³²

²⁶ USDA, "The EU Ban On Agricultural Biotech Products is Illegal," Fact Sheet, found at <http://www.usda.gov/news/releases/2003/05/fs20156.htm>, retrieved Oct. 16, 2003.

²⁷ Press Conference with Agriculture Secretary Ann M. Veneman and U.S. Special Trade Representative, Ambassador Robert B. Zoellick regarding the EU Moratorium on Biotech Crops and Food, May 13, 2003, found at <http://www.usda.gov/news/releases/2003/05/0157.htm>, retrieved Oct. 16, 2003.

²⁸ For example, see U.S. Mission to the EU, "Bush: U.S. Will Not Relent in War Against Terrorism," remarks by President Bush before the U.S. Coast Guard Academy, May 21, 2003 found at <http://www.useu.be/Terrorism/USResponse/May2103BushTerrorism.html>, retrieved Nov. 21, 2003; Press Conference with Agriculture Secretary Ann M. Veneman and U.S. Special Trade Representative, Ambassador Robert B. Zoellick regarding the EU Moratorium on Biotech Crops and Food, May 13, 2003, found at <http://www.usda.gov/news/releases/2003/05/0157.htm>, retrieved Oct. 16, 2003; and U.S. Department of State, "Discussion on the WTO Case on the EU Biotech Moratorium," Foreign Press Center briefing, Washington, D.C., May 14, 2003, found at <http://www.state.gov/e/rls/rm/2003/20727.htm>, retrieved Nov. 21, 2003.

²⁹ USDA, "U.S. and Cooperating Countries File WTO Case Against EU Moratorium On Biotech Foods and Crops," press release, May 13, 2003.

³⁰ Ambassador Zoellick, Press Conference with Agriculture Secretary Ann M. Veneman and U.S. Special Trade Representative, Ambassador Robert B. Zoellick regarding the EU Moratorium on Biotech Crops and Food, May 13, 2003, found at <http://www.usda.gov/news/releases/2003/05/0157.htm>, retrieved Oct. 16, 2003.

³¹ USDA, "U.S. and Cooperating Countries File WTO Case Against EU Moratorium On Biotech Foods and Crops," press release, May 13, 2003.

³² WTO, *European Communities—Measures Affecting the Approval and Marketing of Biotech Products*, "Request for Consultations by the United States," WT/DS291/1, G/L/627, G/SPS/GEN/397, G/AG/GEN/60, G/TBT/D/28, May 20, 2003.

The consultations failed to resolve the dispute, and the United States, Canada, and Argentina requested establishment of a dispute-settlement panel. In August 2003, the Dispute Settlement Body (DSB) agreed to form a single panel to consider the matters raised by the United States, Canada, and Argentina.³³

In a joint press release announcing the U.S. request for establishment of a WTO panel, USDA and USTR stated that the SPS agreement

“recognizes that countries are entitled to regulate crops and food products to protect health and the environment. The WTO SPS agreement requires, however, that members have sufficient scientific evidence for such measures, and that they operate their approval procedures without undue delay. Otherwise, there is a risk countries may, without justification, use such regulations to thwart trade in safe, wholesome, and nutritious products.”³⁴

In announcing the request for the panel, the United States reiterated that “as the EC’s own scientists have stated, there is no scientific basis for either the approval moratorium or the member State bans.”³⁵ Furthermore, the United States clarified that the approval procedures for biotech products set out in EU legislation “are not the focus of the U.S. complaint.” Rather “the United States only asks that those procedures be permitted to proceed to their normal conclusion.” The U.S. panel request lists over 30 biotech products that have been affected by the moratorium.³⁶ As of year end 2003, the panelists had not yet been selected for the dispute-settlement panel.³⁷

EU Regulations

On July 22, 2003, the Council of Ministers formally adopted regulations covering (1) genetically modified (GM) food and feed³⁸ and (2) the traceability³⁹ and labeling of

³³ U.S. Department of State telegram, “Report of Aug. 29, 2003, DSB Meeting,” message reference No. 2946, prepared by U.S. Mission to the WTO, Geneva, Sept. 15, 2003; and WTO, “WTO News Items, Dispute Settlement Body, 29 Aug. 2003, DSB Establishes 6 Panels to Examine 10 Complaints,” found at http://www.wto.org/english/news_e/news03_e/dsb_29aug03_e.htm, retrieved Jan. 21, 2004.

³⁴ USDA and USTR, “United States Requests Dispute Panel in WTO Challenge to EU Biotech Moratorium,” press release 03-54, Aug. 7, 2003.

³⁵ U.S. Department of State, “U.S. Request for WTO Panel on European Biotech Moratorium,” Linnet Daily, U.S. Representative to the World Trade Organization, Statement to the WTO Dispute Settlement Body, Geneva, Switzerland, Aug. 18, 2003, found at <http://www.state.gov/e/eb/rls/rm/2003/23372.htm>, retrieved Nov. 26, 2003.

³⁶ Ibid.

³⁷ The panel was established in March 2004. WTO, *European Communities—Measures Affecting the Approval and Marketing of Biotech Products*, “Constitution of the Panel Established at the Request of the United States, Canada, and Argentina,” WT/DS291/24, Mar. 5, 2004.

³⁸ *Regulation (EC) No 1829/2003 of the European Parliament and of the Council of 22 September 2003 on Genetically Modified Food and Feed*, OJ No. L 268 (Oct. 18, 2003).

³⁹ Traceability refers to the ability to trace biotechnology products through all stages of the production and distribution chains. This directive introduces for the first time into EU legislation the concept of traceability specifically for GMOs. See European Commission, *Explanatory Memorandum, Regulation of the European Parliament and of the Council concerning traceability and labelling of genetically modified organisms and traceability of food and feed products produced from genetically modified organisms and amending Directive 2001/18/EC*, p. 2.

genetically modified organisms (GMOs).⁴⁰ These regulations supplement and provide more details regarding the general provisions in Directive 2001/18. Directive 2001/18 is the main legislation in force in the EU on agricultural biotechnology, and regulates the authorization and use of GMOs, including GM seed, feed, and food.⁴¹ According to the European Commission, the adoption of these two regulations in 2003 completes the legislative framework for regulating agricultural biotechnology in the EU.⁴² The two regulations entered into force on November 7, 2003, although they will not be applied in full until April 2004.⁴³ Both regulations require the European Commission to review its implementation within 2 years of its entry into force.⁴⁴

The regulation on GM food and feed provides for the pre-market authorization and labeling of GM food and feed. The regulation sets a threshold of 0.9 percent for the adventitious or technically unavoidable GM material in conventional food and feed, above which labelling that identifies the presence of GM material is compulsory. The regulation also establishes a 0.5-percent tolerance threshold for the unintended presence of GM material in food and feed that has not yet been authorized but which has received a favorable EU scientific risk assessment. According to the European Commission, above this threshold the product will not be allowed on the market. The provision establishing the 0.5 percent tolerance threshold will expire in 3 years, after which the threshold will fall to zero.⁴⁵

The regulation on traceability and labelling amends Directive 2001/18 to establish specific EU-wide requirements for the traceability and labelling of GMOs. It also establishes traceability requirements for food and feed produced from GMOs. Like the regulation on GM food and feed, this regulation sets a tolerance threshold of 0.5 percent for the unintended presence of GMOs, and a threshold of 0.9 percent for compulsory labelling.⁴⁶

⁴⁰ *Regulation (EC) No 1830/2003 of the European Parliament and of the Council of 22 September 2003 Concerning the Traceability and Labelling of Genetically Modified Organisms and the Traceability of Food and Feed Products Produced From Genetically Modified Organisms and Amending Directive 2001/18/EC*, OJNo. L 268 (Oct. 18, 2003).

⁴¹ *Directive 2001/18/EC of the European Parliament and of the Council of 12 March 2001 on the Deliberate Release into the Environment of Genetically Modified Organisms and Repealing Council Directive 90/220/EEC*, OJNo. L 106 (April 17, 2001). For more information on this directive, see USITC, *The Year in Trade: OTAP, 2002*, USITC publication 3630, pp. 5-5 to 5-8.

⁴² European Commission, "European Legislative Framework for GMOs is Now in Place," press release IP/03/1056, July 22, 2003; and European Commission, "State of Play on GMO Authorizations Under EU Law," press release MEMO/03/221, Nov. 7, 2003.

⁴³ Regulation 1829/2003, art. 49; Regulation 1830/2003, art. 13; and *European Report*, "Biotechnology: Traceability and GMO Labelling Rules Come Into Force," No. 2819 (Nov. 13, 2002), p. IV-2.

⁴⁴ Regulation 1829/2003, art. 48; Regulation 1830/2003, art. 12.

⁴⁵ Regulation 1829/2003, arts. 12, 24, and 47; European Commission, "European Legislative Framework for GMOs is Now in Place," press release IP/03/1056, July 22, 2003; and U.S. Department of State telegram, "Status Request for Biotechnology Regulations," message reference No. 4929, prepared by U.S. Mission to the EU, Oct. 22, 2003.

⁴⁶ Regulation 1830/2003; and European Commission, "European Legislative Framework for GMOs is Now in Place," press release IP/03/1056, July 22, 2003.

In testimony before a Congressional committee in July 2003, the Principal Deputy Assistant Secretary of State for European and Eurasian Affairs Charles Ries, said these regulations may “constitute a technical barrier to trade. The regulations will do little to restore public confidence and will be costly to implement, difficult to enforce, and could put existing biotech trade at risk.”⁴⁷ On November 25, 2003, a group of over 20 U.S. agricultural organizations wrote a letter to Ambassador Zoellick urging the U.S. administration to initiate a WTO dispute settlement proceeding. These groups claim that the new EU rules are “non-tariff trade barriers” and “will result in significant losses to the U.S. food and agriculture industry.”⁴⁸

Canada

Bilateral two-way trade between the United States and Canada, the largest in the world between two countries, was valued at over \$1 billion a day during 2003. U.S.-Canadian commercial relations are governed in large part by the North American Free Trade Agreement (NAFTA), which evolved from a bilateral free trade agreement, the U.S.-Canada Free Trade Agreement (CFTA), signed in 1988, and folded into the NAFTA in 1994.⁴⁹ The bilateral phase-out of duties under CFTA/NAFTA was completed on January 1, 1998. This provided duty-free status for substantially all goods originating in the United States and Canada.⁵⁰ The major trade-related issue in 2003 between the United States and Canada continued to

⁴⁷ Charles Ries, Principal Deputy Assistant Secretary of State for European and Eurasian Affairs, testimony for the House International Relations Committee, July 15, 2003, found at http://www.house.gov/international_relations/108/ries0722.htm, retrieved Jan. 29, 2004. See also, U.S. Department of State, Office of the Spokesman, Taken Question from July 2, 2003 Daily Press Briefing, “EU: European Parliament Legislation on Biotech Food,” July 3, 2003, found at <http://www.state.gov/r/pa/prs/ps/2003/22236.htm>, retrieved Nov. 26, 2003. For more details on the U.S. position, see WTO, “Response From the European Commission to Comments Submitted by WTO Members Under Either or Both G/TBT/N/EEC/7 and G/SPS/N/EEC/150 (Proposal for a Regulation of the European Parliament and of the Council on Traceability and Labeling of Genetically Modified Organisms and Traceability of Genetically Modified Food and Feed–COM(2001)182 Final)”, G/SPS/GEN/338, G/TBT/W/180, July 26, 2002.

⁴⁸ Letter to Ambassador Zoellick, Nov. 25, 2003, from the American Farm Bureau Federation, American Feed Industry Association, American Meat Institute, American Seed Trade Association, American Soybean Association, Biotechnology Industry Organization, Corn Refiners Association, Corn Refiners Association, CropLife America, Grocery Manufacturers of America, National Association of State Departments of Agriculture, National Association of Wheat Growers, National Corn Growers Association, National Cotton Council, National Grain and Feed Association, National Food Processors Association, National Grain Trade Council, National Oilseed Processors Association, National Renderers Association, North American Millers Association, U.S. Grains Council, USA Rice, and Wheat Export Trade Education Committee, found at <http://www.ncga.com/letters/index.html>, retrieved Jan. 29, 2004.

⁴⁹ Additional information on NAFTA is provided in chapter 3.

⁵⁰ Duty-free status exists for most bilaterally traded goods, except for certain supply-managed products in Canada and dairy, sugar, peanuts, and cotton in the United States. The CFTA entered into force in January 1989 and allowed for successive duty reductions over a 10-year period. NAFTA entered into force on Jan. 1, 1994. The timetable for duty reductions as well as most of the terms of the CFTA were incorporated into NAFTA.

involve softwood lumber after the expiration in the spring of 2001 of a bilateral agreement between the two countries governing trade in that sector and the resolution of subsequent trade disputes.

Following two consecutive years of decline, U.S. trade with Canada increased in 2003. U.S. exports, valued at \$148.7 billion, increased over \$6 billion (4.4 percent) from 2002, while U.S. imports from Canada totaled \$224.0 billion, an increase of over \$13 billion (6.4 percent) from 2002. The leading U.S. exports to Canada in 2003 were all major motor vehicle products, including parts and accessories for bodies of motor vehicles, passenger motor vehicles, and parts and accessories for motor vehicles, and piston engines. The leading U.S. imports from Canada during 2003 included passenger motor vehicles, natural gas, and crude petroleum. The U.S. trade deficit with Canada was \$75.3 billion, a nearly 11 percent increase from 2002. U.S.-Canadian trade data are shown in tables A-19 through A-21.⁵¹

Softwood Lumber

During 2003, the United States and Canada were awaiting decisions from both NAFTA and WTO dispute settlement panels addressing final affirmative determinations made by Commerce and the USITC, relating to certain softwood lumber products from Canada. These panels were established to review Canadian challenges to the final affirmative antidumping (AD), countervailing duty (CVD), and injury determinations that had been made by Commerce and the ITC in the spring of 2002.

In 2003, NAFTA review panels returned decisions on the final affirmative antidumping, countervailing duty, and injury determinations that had been brought to the Secretariat in the spring of 2002.

At yearend 2003, the WTO review panels had issued reports on the countervailing duty determination made by Commerce, however no report had yet been issued on the antidumping and injury determinations made by Commerce and the ITC.

The status of the 2003 NAFTA and WTO dispute settlement panels, including the appeals and decisions, are discussed below.

Background

The petitions that led to the CVD and AD orders were filed with Commerce and the USITC in April, 2001, following the expiration of the U.S.-Canada Softwood Lumber Agreement (SLA).⁵² Although negotiations were conducted, the United States and

⁵¹ U.S. trade with NAFTA partners is shown in table 4-2.

⁵² The SLA, in effect during 1996-2001, expired in March 31, 2001. Under the SLA, Canada agreed to impose a fee on softwood lumber exports to the United States above specified limits, and the United States committed not to initiate or otherwise take action under several U.S. trade statutes with respect to softwood lumber imports from Canada.

Canada did not reach a new agreement before the SLA expired. The U.S. lumber industry filed petitions⁵³ with Commerce and the Commission under the U.S. countervailing duty (CVD) and antidumping (AD) laws in 2001. Investigations were initiated, and both agencies issued preliminary affirmative determinations in 2001 and final affirmative determinations in 2002.

In making final affirmative determinations, Commerce on March 22, 2002, found a countrywide countervailable subsidy of 18.79 percent, and margins of dumping ranging from 2.18 percent to 12.44 percent.⁵⁴ On May 16, 2002, the Commission determined that the U.S. lumber industry was threatened with material injury by reason of dumped and subsidized imports from Canada, thus triggering the imposition of permanent duties.⁵⁵ These three decisions were appealed by Canada through both the NAFTA and WTO dispute settlement mechanisms.

2003 NAFTA Review Panel Decisions

Antidumping determination

On July 17, 2003 a binational panel unanimously affirmed in part and remanded in part Commerce's final affirmative antidumping determination that certain softwood lumber was exported from Canada to the United States during the period April 1, 2000 to March 31, 2001 at prices that were less than fair value (LTFV).⁵⁶ The Panel ruled in favor of the United States that Commerce acted lawfully in its initiation of the dumping investigation, and that Commerce's practice of "zeroing" was consistent with U.S. domestic law. However the Panel found that Commerce had not made adjustments for differences in physical characteristics between softwood lumber products, and that more information was required to justify Commerce's single "class or kind" merchandise determination with respect to engineered wood products. Consequently, the Panel found that Commerce made calculation errors in the costs for specific Canadian respondents.

The NAFTA panel remanded these issues to Commerce, and ordered it to issue a remand determination within sixty days, recalculating the antidumping duties it had imposed on Canada's softwood lumber industry. Commerce filed a Determination on

⁵³ The petitioners included: Coalition for Fair Lumber Imports Executive Committee, Washington, D.C.; the United Brotherhood of Carpenters and Joiners, Portland, OR; and the Paper, Allied-Industrial, Chemical and Energy Workers International Union, Nashville, TN. USITC, *Conditions of Competition in the U.S. Market for Wood Structural Building Components*, investigation No. 332-445, USITC publication 3596, April 2003.

⁵⁴ 67 F.R. 15545, April 2, 2002. Commerce exempted from the CVD determination softwood lumber products from the Maritime Provinces unless they had been produced on Crown lands.

⁵⁵ USITC, *Softwood Lumber from Canada*, USITC publication No. 3509, investigation Nos. 701-TA-414 and 731-TA-928 (Final), May 2002.

⁵⁶ See *Certain Softwood Lumber Products from Canada* (Notice of Amended Final Determination of Sales at Less than Fair Value and Antidumping Duty Order), 67 Fed. Reg. 36068 (May 22, 2002), corrected, May 30, 2002, 67 Fed. Reg. 37775 (May 30, 2002).

Remand on October 15, 2003, and the Panel issued a decision on this remand determination on March 5, 2004, and Commerce issued a second remand determination on April 21, 2004 which affirmed Commerce in part and remanded on the following issues:

- 1) to recalculate Tembre's General and Administrative expenses
- 2) to calculate the by product offset to West Fraser's production, and
- 3) to treat Slawn's future trading results upon adjustment

Countervailing duty determination

On August 13, 2003, a binational panel unanimously affirmed in part and remanded in part Commerce's final affirmative countervailing duty determination. In its Final Determination, Commerce concluded that provincial stumpage programs under which Canadian provinces confer rights to harvest standing timber on government-owned forestlands are subsidies to producers of softwood lumber which are countervailable under U.S. law.⁵⁷ The NAFTA panel affirmed Commerce that provincial stumpage programs provide a financial contribution, but found that Commerce had not proved that Canadian softwood lumber producers benefitted from provincial stumpage programs. In that regard, the NAFTA panel found that when Commerce used cross-border benchmarks to determine whether provincial stumpage programs confer a benefit, it incorrectly based its benefit finding on the U.S. stumpage prices rather than on the prevailing market conditions in Canada.⁵⁸

In its August 2003 decision, the Panel remanded to Commerce to reconsider the methodology used to measure the benefit accruing to Canadian lumber producers from Canadian Provincial stumpage programs as well as certain company exclusion, scope, and calculation issues.⁵⁹ Commerce filed its Determination on Remand on January 12, 2004.⁶⁰

Injury determination

On September 5, 2003, the NAFTA Dispute Panel unanimously affirmed in part and remanded in part the ITC's determinations that Canada's softwood lumber exports

⁵⁷ See Notice of Final Affirmative Countervailing Duty Determination and the Final Negative Critical Circumstances Determination: Certain Softwood Lumber Products from Canada, 67 FR 15545 (April 2, 2002) (\$ Final Determination).

⁵⁸ NAFTA, Certain Softwood Lumber Products from Canada (Department of Commerce Final Affirmative Countervailing Duty Determination and Final Negative Critical Circumstances Determination), USA-CDA-2002-1904-03 (Active), found at http://www.nafta-sec-alena.org/DefaultSite/dispute/index_e.aspx?articleid=380, retrieved Jan. 27, 2004.

⁵⁹ U.S. International Trade Administration, Remand Determination Implementing a NAFTA Panel Decision: Canada's Challenge to the Final Determination in the Countervailing Duty Investigation on Imports of Softwood Lumber from Canada, found at http://www.ita.doc.gov/media/FactSheet/0104/lumber_011204.html, retrieved Jan. 22, 2004.

⁶⁰ For more on Commerce's Jan. 12, 2004 Remand Determination please see: http://www.ita.doc.gov/media/FactSheet/0104/lumber_011204.html.

threatened to materially injure the U.S. softwood lumber industry. The Panel ordered the ITC to issue a remand determination within 100 days.⁶¹

On December 15, 2003, the ITC delivered its remand determination to the NAFTA binational panel.⁶² The USITC reaffirmed on remand that an industry in the United States is threatened with material injury by reason of imports of softwood lumber from

Canada that Commerce had determined are subsidized and sold in the United States at less than fair value. The Panel's decision on the December 15 remand was released on April 29, 2004. The Commission issued a second remand determination on June 10, 2004.

2003 WTO Review Panel Decisions

Antidumping determination

The Panel was established on January 8, 2003, and was composed on March 4, 2003. The Final Report of the Panel was to be circulated in April 2004.

Countervailing duty determination

On August 29, 2003, the WTO panel found that Commerce Final Countervailing Duty Determination was inconsistent with the provisions afforded in the Subsidies and Countervailing Measures Agreement (SCM) and of GATT 1994.⁶³

On October 21, 2003, the United States notified its decision to appeal to the Appellate Body certain issues of law and certain legal interpretations developed by the Panel.⁶⁴ Canada also challenged a number of aspects of the final determination by the Commerce that led to the imposition of the duties.⁶⁵

On December 17, 2003, in a communication from the Appellate Body, it was announced that the Appellate Body Report in this appeal was scheduled to be circulated to WTO members by January 19, 2004.

⁶¹ NAFTA, A certain Softwood Lumber Products from Canada (USITC Final Injury Determination), USA-CDA-2002-1904-07 (Active), found at http://www.nafta-sec-alena.org/DefaultSite/dispute/index_e.aspx?articleid=380, retrieved Jan. 27, 2004.

⁶² WTO, A United States-Final Dumping Determination on Softwood Lumber Products from Canada, WT/DS264/5, (03-6458), Dec 8, 2003.

⁶³ WTO, A United States - Final Countervailing Duty Determination With Respect to Certain Softwood Lumber from Canada - Report of the Panel, WT/DS267/R, (03-4360), Aug. 29, 2003.

⁶⁴ WTO, A United States - Final Countervailing Duty Determination With Respect to Certain Softwood Lumber From Canada- Notification of Appeal By the United States Under Paragraph 4 of Article 16 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), @ WT/DS257/8, (03-5606), Oct. 24, 2003.

⁶⁵ WTO, A United States - Final Countervailing Duty Determination With Respect to Certain Softwood Lumber from C anada, @ WT/DS257/AB/R, Jan. 19, 2004.

Injury determination

The Panel was established on May 7, 2003, submissions and meetings were held in the summer and fall of 2003, and the Panel was expected to circulate its report in March 2004.

Mexico

Mexico maintained its position in 2003 as the third-largest U.S. trading partner after the European Union, Canada, and before China. U.S. exports to Mexico in 2003 were valued at \$83.1 billion, a continued decline (3.4 percent) from \$86.1 billion in 2002. U.S. imports from Mexico were valued at \$137.2 billion, a continued increase (2.3 percent) from \$134.1 billion in 2002. Falling U.S. exports and rising U.S. imports widened the U.S. trade deficit with Mexico in 2003 once again, to \$54 billion from \$48 billion in 2002. U.S. exports to Mexico were depressed principally by a continuing decline in exports of parts for the assembly of computers, telephone equipment, and motor vehicles. The rise of overall U.S. imports from Mexico were accounted for to a large degree by higher prices for petroleum. U.S.-Mexican trade data are shown in tables A-22 through A-24.

Agricultural imports from the United States and their possible adverse effects on Mexican farming interests, as perceived by Mexico, continued to be in the forefront of U.S.-Mexican trade relations in 2003. Mexico is currently the United States' third largest single-country export market. A year-end event on another notable trade issue was that the WTO supported a long-standing U.S. complaint regarding Mexico's telecommunications practices. However, the year 2003 brought no major changes with respect to some other, important long-standing trade issues, including bilateral trade in sweeteners, and U.S. implementation of NAFTA cross-border trucking provisions.

Restrictions on Agricultural Imports from the United States

The year 2003 began with the elimination of the remaining tariffs on some 90 percent of Mexico's imports of agricultural and livestock products from the United States (excluding corn, sugar, dry edible beans, and powdered milk), as stipulated by the North American Free Trade Agreement (NAFTA).⁶⁶ Remaining tariffs will be phased out by January 1, 2008. Although Mexico's tariffs on most U.S. farm products had been less than 2 percent ad valorem before they were eliminated, the events triggered opposition by Mexican growers and ranchers. In response to pressure from these

⁶⁶ United States Department of Agriculture, Foreign Agricultural Service, "Mexico's NAFTA Tariff Schedule for 2003," *Gain Report* MX3011, Jan. 23, 2003.

groups, which already escalated during 2002,⁶⁷ Mexican authorities began to seriously consider NAFTA and the U.S. farm bill of 2002⁶⁸ as possible problems for domestic farming interests.

On April 28, 2003, Mexican President Vicente Fox signed a "National Agreement on Agriculture (NAA)," a follow-up to the "Agricultural Armor Package" announced in November 2002.⁶⁹ NAA is the first framework accord in the NAFTA era between the government and farmers of Mexico that contains various programs in support of domestic farmers and rural communities.⁷⁰ In the area of trade with NAFTA partners, major provisions of the NAA included the following:

- The Government of Mexico (GOM) and agricultural producer groups will conduct a joint evaluation of the NAFTA agricultural chapter and its effect on Mexico's rural sector.
- The GOM and agricultural producer groups will conduct a joint study of the U.S. farm bill.
- The GOM will address the continued use of agricultural subsidies by the United States and Canada since the implementation of the NAFTA; the GOM will consider applying all available defense mechanisms as provided for in the NAFTA. In addition, the GOM will seek consultations with the United States and Canada to consider the addition of new articles and annexes to NAFTA to address existing agricultural asymmetries.
- The GOM will support Mexico's recognition as a developing country under the provisions of the WTO and propose the immediate elimination of export and internal subsidies that distort international trade. In addition, the GOM will reserve the right to reintroduce tariffs and quantitative restrictions for reasons of national sovereignty and security.⁷¹

NAA also calls for \$267 million newly budgeted funds to pay for a variety of programs, including farm credits, rural roads and housing, electricity, and educational and health services for farmers.

In recent years Mexico has issued antidumping duty orders, applied safeguards SPS measures, and invoked discriminatory custom procedures. During 2003, Mexico eliminated or delayed implementation of some of these barriers, but some remain and new ones are under consideration.

⁶⁷ For background, see USITC, *The Year in Trade, 2002: OTAP*, USITC publication 3630, Aug. 2003, pp. 5-11 to 5-15.

⁶⁸ Farm Security and Rural Investment Act, Pub. L. 107171.

⁶⁹ For background, , see USITC, *The Year in Trade: OTAP, 2002*, USITC publication 3630, Aug. 2003, pp. 5-11 to 5-15.

⁷⁰ "Government of Mexico Signs National Agreement on Agriculture," United States Department of Agriculture, Foreign Agricultural Service, May 9, 2003; Gain Report #MX3067; found at <http://www.USDA.Gain Report> retrieved Nov. 29, 2003.

⁷¹ Ibid.

Sweetener imports continued to be a major source of disagreement between the two countries during the year. Although on May 20, 2002, Mexico removed the antidumping duties levied on high-fructose corn syrup (HFCS) imports, as both the WTO and NAFTA ruled that they conflicted with Mexico's commitments,⁷² in January 2002, the Mexican Congress imposed a 20-percent sales and distribution tax on soft drinks sweetened with any sweetener other than sugar. This tax effectively eliminated the use of HFCS in the Mexican beverage industry; significantly reduced U.S. sales to Mexico of HFCS, and lowered U.S. corn exports to Mexico used to produce HFCS.⁷³ The Mexican Congress voted in December 31, 2002 to continue this tax, despite efforts by various parties, including President Fox, to have it removed.⁷⁴

In June 2003, the United States requested WTO consultations with respect to antidumping measures applied by Mexico to imports of U.S. beef and U.S. long-grain white rice, and with respect to Mexico's trade statute. The United States alleged that the measures, applied initially in April 2000 and June 2002, respectively, and certain provisions of Mexico's trade law, are inconsistent with Mexico's obligations under the WTO antidumping agreement. The consultations were held on July 31 and August 1, 2003, and failed to resolve the issues. In September 2003, the United States formally requested establishment of a WTO panel to review Mexico's measures on long grain white rice, and a panel was formed in November.

Mexico imposed a provisional NAFTA safeguard measure on imports of U.S. chicken leg quarters in January 2003, and a final safeguard measure on July 24, 2003. Through an exchange of letters on July 24 and 25, the two countries' reconciled their positions on this issue. Mexico agreed to provide compensation to the United States for Mexico's safeguard measure. The United States consented to the application of the safeguard past December 31, 2003 – the expiration of the phase-out period for Mexican tariffs on U.S. chicken leg quarters. Mexico committed, among other things, not to impose any additional import restrictions on poultry products; to eliminate certain sanitary restrictions on such products; and to consult with the United States in advance regarding new sanitary measures.⁷⁵

⁷² For background, see USITC, *The Year in Trade, 2000: OTAP*, USITC publication 3428, June 2001, pp. 4-17 to 4-18; USITC, *The Year in Trade, 2001: OTAP*, USITC publication 3510, May 2002, pp. 5-16 to 5-17; USITC, *The Year in Trade, 2002: OTAP*, USITC publication 3630, Aug. 2003, pp. 5-15 to 5-17.

⁷³ USTR, "USTR, , " *2004 Trade Policy Agenda and 2003 Annual Report, of the President of the United States on the Trade Agreements Program*," March 2004, pp. 122-123.

⁷⁴ The decision to sustain the tax was subsequently published in a *Diario Oficial*, Dec. 31, 2003. In March, 2004, the United States filed a WTO complaint against Mexico against this tax. WT/DS295/1. See also World Trade Organization, "Mexico - Definitive Anti-dumping Measures on Beef and Rice, Request for Consultations by the United States," June 23, 2003.

⁷⁵ USTR, *2004 Trade Policy Agenda and 2003 Annual Report of the President of the United States on the Trade Agreements program*, Mar. 2004. pp.122-23.

However, despite progress made towards resolving agricultural problems, affected U.S. producers, U.S. exporters and the U.S. Government have become increasingly concerned about Mexico's unilateral restrictions against certain imports from the United States. On September 23, 2003, the U.S. Senate Committee on Finance held a hearing on Mexican barriers imposed against such imports and the harm they may have caused to U.S. interests.⁷⁶

Telecommunications Services

On November 26, 2003, a WTO panel issued interim ruling in the long-standing bilateral telecommunications dispute and the WTO panel ruling was released on April 2, 2004.⁷⁷

The dispute concerns regulations that governed the operations of Teléfonos de Mexico (Telmex), Mexico's largest telecommunications company and interconnection fees imposed by Telmex to complete long distance calls.⁷⁸

Market barriers in the Mexican telecommunications sector remained a serious concern for the United States during 2003 as Mexico continued to fail to enforce its own regulations. As a result, wholesale telecommunications rates for U.S.-Mexico telephone calls remained at roughly four times their cost, costing U.S. companies and consumers hundreds of millions of dollars in excess payments a year.⁷⁹

According to a USTR press release the WTO panel agreed with the United States on most of the major claims in this dispute, finding:

- Mexico breached its commitment to ensure that U.S. carriers can connect their international calls to Mexico's major supplier, Telmex, at cost-based rates.
- Mexico breached its obligation to maintain appropriate measures to prevent its dominant carrier from engaging in anti-competitive practices, by granting Telmex the exclusive authority to negotiate the rate that all Mexican carriers charge U.S. companies to complete calls originating in the United States.
- Mexico breached its obligations under the WTO Services Agreement, the GATS, by
- failing to ensure that U.S. carriers operating within Mexico can lease lines from Mexican

⁷⁶ U.S. Committee on Finance, Senator Chuck Grassley of Iowa, Chairman, press release, Oct. 6, 2003. The letter went to Ernesto Derbez, Foreign Minister; Fernando Canales, Secretary of the Economy; and Javier Bernardo Usabiaga Arroyo, Secretary of Agriculture.

⁷⁷ USTR, "U.S. Wins Telecommunications Case against Mexico in WTO," press release 04-17, Mar. 12, 2004.

⁷⁸ Ibid

⁷⁹ USTR, "2004 Trade Policy Agenda and 2003 Annual Report of the President of the United States on the Trade Agreements Program," Mar. 2004, pp. 122-23.

- carriers (and thereby provide services on a resale basis).⁸⁰

However, the WTO panel agreed with Mexico's claim that Mexico's commitments under the WTO were valid only in regard to "facilities-based" telecommunications services, i.e., companies providing services over networks that they own and not those providing services over leased lines.⁸¹

Japan

The U.S. merchandise trade deficit with Japan decreased from \$73.0 billion in 2002 to \$69.6 billion in 2003. U.S. exports to Japan increased from \$48.3 billion to \$48.9 billion or by 1.2 percent during 2002-03. U.S. imports from Japan declined by 2.3 percent from \$121.3 billion to \$118.5 billion during the same period. The leading

exports to Japan during 2003 were airplanes and other aircraft, parts of airplanes or helicopters, corn, semiconductors, soybeans, and cigarettes. The leading imports from Japan during 2003 were motor vehicles with cylinder capacity over 3,000 cc, passenger motor vehicles with cylinder capacity over 1,500 but not over 3,000 cc, parts and accessories for computers, still video cameras and other video camera recorders, and parts and accessories for motor vehicles. U.S.-Japan trade data are shown in appendix tables A-25 through A-27.

The umbrella for bilateral discussions between the United States and Japan was the "U.S.-Japan Economic Partnership for Growth." Bilateral consultations were also held on the following topics: public works, guitar IPR issues, beef safeguards, rice, phytosanitary issues, visas and passports, wood products, and marine craft.⁸²

U.S.-Japan Economic Partnership for Growth

The U.S.-Japan Economic Partnership for Growth (Partnership) was launched by President George W. Bush and Prime Minister Junichiro Koizumi on June 30, 2001. The purpose of the Partnership was to promote economic growth and open markets by focusing on sectoral and cross-sectoral issues related to regulatory and competition policy.⁸³ Several initiatives were started under the Partnership including the Regulatory Reform and Competition Policy Initiative (Regulatory Reform Initiative), the

⁸⁰ USTR, "U.S. Wins Telecommunications Case against Mexico in WTO," press release 04-17, Mar. 12, 2004.

⁸¹ Ibid

⁸² U.S. Department of State telegram, "Second Meeting of the U.S.-Japan Trade Forum," message reference No. 330052, prepared by U.S. Department of State, Washington, D.C., Dec. 1, 2003.

⁸³ USTR, "Annual Reform Recommendations from the Government of the United States to the Government of Japan under the U.S.-Japan Regulatory Reform and Competition Policy Initiative," Oct. 24, 2003, found at <http://www.ustr.gov>, retrieved Nov. 5, 2003.

Investment Initiative, the Financial Dialogue, and the Trade Forum.⁸⁴ A brief discussion of activities in 2003 follows.

During 2003, Working Groups and the High-Level Officials Group met to discuss reform proposals under the Regulatory Reform Initiative. The Second Report to Leaders was submitted to President Bush and Prime Minister Koizumi on May 23, 2003. The report contained regulatory reform measures that Japan had implemented and would implement.⁸⁵

On October 24, 2003, the United States submitted its annual reform recommendations to the Government of Japan under the U.S.-Japan Regulatory Reform and Competition Policy Initiative. The recommendations focused on issues that Prime Minister Koizumi had identified as important for reform including telecommunications, information technologies, medical, energy, and competition policy. The U.S. recommendations focused particularly on the Special Zones for Structural Reform that empower local governments in Japan to establish zones where businesses can operate without onerous regulations. As of October 24, 2003, 164 zones had been approved by the Prime Minister.⁸⁶ The zones are expected to be of significant commercial interest to U.S. business such as those that are established at seven of Japan's major air and sea ports where overtime charges associated with customs processing have been cut in half.⁸⁷ The United States encouraged Japan to expand the deregulation measures in the zones on a nationwide basis.

Other steps that Japan is to take under the Regulatory Reform Initiative are:

- Introducing competition in the telecommunications sector,
- Extending the term of copyright protection for cinematographic works from 50 to 70 years,
- Expanding the liberalization of the retail electricity sector,
- Improving the speed and efficiency of approval processes for medical devices and pharmaceuticals,
- Strengthening the Japan Fair Trade Commission (JFTC),
- Improving merger techniques, and

⁸⁴ For additional information on the Partnership, see USITC, *The Year in Trade, 2001: OTAP*, publication 3510, pp. 4-25 through 4-27.

⁸⁵ USTR, *2003 National Trade Estimates Report on Foreign Trade Barriers*, Mar. 31, 2004.

⁸⁶ USTR, "Annual Reform Recommendations from the Government of the United States to the Government of Japan under the U.S.-Japan Regulatory Reform and Competition Policy Initiative," Oct. 24, 2003, found at <http://www.ustr.gov>, retrieved Nov. 5, 2003.

⁸⁷ USTR, "Second Report to the Leaders on the U.S.-Japan Regulatory Reform and Competition Policy Initiative," Fact Sheet, May 23, 2003, found at <http://www.ustr.gov>, retrieved Nov. 5, 2003, and USTR, "USTR Zoellick Commends Japan for Deregulation Zones," press release 03-33, May 23, 2003; found at <http://www.ustr.gov>, retrieved Nov. 5, 2003.

- Reducing overtime fees associated with customs procedures at Japan's major air and sea ports.

The Investment Initiative includes laws, regulations, policies, and other measures intended to improve the climate for foreign direct investment. At the most recent meeting in November 2003, the topics discussed were mergers and acquisitions, tax, labor, and land policy.⁸⁸

The Financial Dialogue serves as a forum for the U.S. Department of the Treasury, Japan's Ministry of Finance, and the Financial Services Agency to exchange information on key macroeconomic and financial sector issues, including non-performing loans. The third meeting of this group was convened in November 2003 in Washington, D.C.⁸⁹

The Trade Forum, which is led by USTR and Ministers of Foreign Affairs (MOFA), focuses on a wide-range of sectoral trade issues of concern to both governments. The Trade Forum meets at least once per year. At the second meeting of the Trade Forum in July 2003, issues that were raised included agriculture, public works, and new U.S. visa and passport regulations.⁹⁰

China

China is the United States' third largest trading partner in terms of total trade (exports and imports), following Canada and Mexico. In 2003, U.S.-China trade totaled \$178 billion, an increase of 23 percent compared with 2002. U.S. exports to China increased by 30 percent to \$27 billion in 2003. U.S. imports rose 22 percent in 2003 to \$152 billion, resulting in a \$125 billion trade deficit with China in 2003. Leading U.S. exports to China during the year included soybeans, aircraft, integrated circuits, cotton, and fertilizers. Leading U.S. imports from China included computer input and output units, parts, and accessories; footwear; portable automatic data processing machines; transmission apparatus; and video recording devices (tables A-28 through A-30).

China's compliance with the terms of its accession to the WTO remained a major focus of the U.S.-China trade relationship in 2003, which is discussed below. Other issues during the year included U.S. industry on petitions filed under the China-specific safeguard mechanism (section 421 of the Trade Act of 1974),⁹¹ and actions

⁸⁸ USTR, *2003 Trade Policy Agenda and 2003 Annual Report*, Mar. 2004.

⁸⁹ Ibid.

⁹⁰ Ibid.

⁹¹ For more information, see the section on Safeguard Actions in chapter 2 of this report and USTR, *2004 Trade Policy Agenda and 2003 Annual Report*, Mar. 2004, p. 223.

addressing three categories of U.S. imports of Chinese textiles and apparel under the special textile safeguard mechanism.⁹² Also, President Bush and other U.S. Government officials urged China to move away from its policy to peg its currency (the renminbi or RMB) to the U.S. dollar to a policy supporting a market-driven, freely floating exchange rate.⁹³

U.S. Assessment of China's WTO Compliance in 2003

On December 11, 2001, China became the 143rd member of the WTO. WTO accession required China to make commitments covering a large number of areas, including import and export regulations, internal policies affecting trade (such as taxation and subsidies), investment, agriculture, intellectual property rights (IPR), services, the legal trade framework, and trading rights and distribution services. USTR is required to report annually to Congress on China's compliance with its WTO commitments.⁹⁴ In its report covering 2003, USTR reported that although there were some positive developments, China's WTO implementation efforts "lost a significant amount of momentum."⁹⁵ Furthermore, unlike 2002, "China's uneven and incomplete WTO compliance record can no longer be attributed to start-up problems."⁹⁶

Agriculture, services, enforcement of IPR, and transparency of government regulations across sectors remained major areas of U.S. concern. New issues in 2003 included certain tax and industrial policies that encourage domestic production.⁹⁷ In particular, USTR stated that China applies discriminatory value-added tax (VAT) rates to imports of fertilizers and semiconductors, whereas domestic production either is exempted from or receives a substantial rebate of the VAT.⁹⁸ USTR also highlighted

⁹² For more information, see textiles section and USTR, *2004 Trade Policy Agenda and 2003 Annual Report*, March 2004, pp. 223-24.

⁹³ For example, see The White House, Office of the Press Secretary, "Background Briefing by a Senior Administration Official on the President's Meeting with the President of China," Oct. 19, 2003; The White House, Office of the Press Secretary, "Background Briefing on the President's Meeting with Chinese Premier Wen," Dec. 9, 2003; and Honorable John B. Taylor, Under Secretary of Treasury for International Affairs, U.S. Department of the Treasury, Testimony before the Full Committee of the House Committee on Ways and Means, Oct. 30, 2003, found at Internet address www.waysandmeans.house.gov, retrieved Mar. 29, 2004. In February 2004, U.S. and Chinese officials met for the first time under the recently agreed technical cooperation program to discuss exchange rate issues. U.S. Department of State telegram, "First Meeting of the Technical Cooperation Program: U.S. and China Outline Goals for Further Cooperation on Exchange Rate Management Issues," message reference No. 3792, prepared by U.S. Embassy, Beijing, Mar. 5, 2004.

⁹⁴ *Ibid.*, p. 4.

⁹⁵ *Ibid.*, p. 3.

⁹⁶ USTR, *2003 Report To Congress on China's WTO Compliance*, Dec. 11, 2003, p. 1.

⁹⁷ *Ibid.*, pp. 4-5.

⁹⁸ USTR, *2003 Report To Congress on China's WTO Compliance*, Dec. 11, 2003, p. 32. On March 18, 2004, the United States requested WTO consultations with China regarding China's VAT on integrated circuits. WTO, *China-Value-Added Tax on Integrated Circuits, Request for Consultations by the United States*, WT/DS309/1, Mar. 23, 2004.

China's proposed industrial policy for the automotive sector, which favors domestic production through various measures, including restrictions on imports of certain auto-related products.⁹⁹

Agriculture

China reduced tariffs on agricultural products as scheduled on January 1, 2003, and U.S. exports of some agricultural goods continued to climb during the year. However, USTR cited a number of nontariff barriers that limited U.S. agricultural exports in 2003, including the administration of its tariff-rate quotas (TRQs) and sanitary and phytosanitary measures. Upon accession, China agreed to establish a TRQ system for imports of certain bulk commodities, including wheat, corn, cotton, rice, and vegetable oils. In 2003, the most serious problems with TRQ administration identified in 2002 continued; namely, lack of transparency in TRQ allocation and management, subdivision of the TRQ into subquotas, small allocation sizes, and burdensome licensing procedures.¹⁰⁰ Following a series of bilateral meetings, China issued new regulations in October 2003 that addressed most of the U.S. issues and will apply to shipments beginning January 1, 2004.¹⁰¹

According to USTR, in 2003 China increasingly imposed SPS measures that are affecting or threatening to affect U.S. shipments of agricultural products. U.S. exports that have been affected by SPS standards include wheat, raw poultry and meat, and processed foods that use certain food additives. China also threatened to suspend U.S. soybean imports from four companies for SPS reasons.¹⁰² U.S. officials are also meeting with their Chinese counterparts to discuss burdensome certification requirements on imported seafood products and live aquatics.¹⁰³

Other issues in the agricultural sector that the U.S. Government continued to address with China in 2003 included systemic problems with biotechnology regulations on safety, testing, and labeling, affecting mostly soybeans;¹⁰⁴ inspection-related requirements, which USTR states are burdensome, selectively enforced, and are being used to control the pace and quantity of some imports; and export subsidies on corn.¹⁰⁵

⁹⁹ USTR, *2003 Report To Congress on China's WTO Compliance*, Dec. 11, 2003, pp. 5, 40-41.

¹⁰⁰ *Ibid.*, pp. 4, 46.

¹⁰¹ *Ibid.*, p. 46.

¹⁰² As of February 2004, China had not taken measures against the four U.S. soybean shippers. U.S. Department of State telegram, "Priority Trade Issues, 2003 Year-End Report," message reference No. 1560, prepared by U.S. Embassy, Beijing, Feb. 3, 2004.

¹⁰³ USTR, *2003 Report To Congress on China's WTO Compliance*, Dec. 11, 2003, p. 47.

¹⁰⁴ Following a series of extensions in 2002 and 2003 to provide temporary safety certificates, in February 2004 China issued permanent safety certificates for biotech soybeans. U.S. Department of State telegram, "Priority Trade Issues, 2003 Year-End Report," message reference No. 1560, prepared by U.S. Embassy, Beijing, Feb. 3, 2004; and U.S. Department of State telegram, "JCCT March 9, 2004 Planning Meeting," message reference No. 3895, prepared by U.S. Embassy, Beijing, Mar. 12, 2004.

¹⁰⁵ USTR, *2003 Report To Congress on China's WTO Compliance*, Dec. 11, 2003, pp. 44, 45, 48.

Services

According to USTR, in the services sector in 2003, "China continued to keep pace nominally with the opening required by its WTO accession agreement," but market access barriers remained in many service sectors. For example, in the banking sector, excessive working capital requirements and other prudential rules restricted the ability of foreign banks to establish and expand their market share. Excessive capital requirements also restricted foreign suppliers of insurance, telecommunications, and distribution services from entering the market. Other issues included restrictions on the opening of new branches, in particular in the insurance i.e., and legal services sectors, as well as a lack of regulatory and licensing transparency, the licensing procedures in the insurance sector. Other service sectors that were the focus of concerns in 2003 included motor vehicle financing, express delivery services, and construction and related engineering services. According to USTR, no significant problems had emerged as of year-end 2003 from China's implementation of commitments in audio-visual services, certain professional services, tourism and travel-related services, educational services, and environmental services.¹⁰⁶

Intellectual Property Rights

According to USTR, although some improvements are still required, China's framework of IPR laws and regulations is "largely satisfactory."¹⁰⁷ The principal area of U.S. concern is the lack of effective IPR enforcement,¹⁰⁸ resulting primarily from "the failure to provide a truly deterrent enforcement system."¹⁰⁹ In USTR's Special 301 Report issued in May 2003, USTR indicated that violations of IPR in China are "still rampant."¹¹⁰ More recently, USTR notes that IPR infringements remain "pervasive....Violations include the rampant piracy of film, music publishing, and software products; infringement of pharmaceutical, chemical, information technology, and other patents; and counterfeiting of consumer goods, electrical equipment, automotive parts, and industrial products."¹¹¹ In 2003, China remained the leading source of counterfeit goods seized on entering the United States.¹¹²

¹⁰⁶ Ibid., pp. 55-57, 64.

¹⁰⁷ Ibid., p. 49.

¹⁰⁸ USTR, *2003 Report To Congress on China's WTO Compliance*, Dec. 11, 2003, p. 49; and USTR, *2004 Trade Policy Agenda and 2003 Annual Report*, Mar. 2004, p. 163.

¹⁰⁹ U.S. Department of State telegram, "China IPR: Year 2004 Special 301 Review," message reference No. 3185, prepared by U.S. Embassy, Beijing, Feb. 25, 2004. See also, USTR, *2003 Report To Congress on China's WTO Compliance*, Dec. 11, 2003, p. 52.

¹¹⁰ USTR, *2003 Special 301 Report*, found at <http://www.ustr.gov/reports/2003/special301-306.htm>, retrieved Apr. 1, 2004.

¹¹¹ USTR, *2004 Trade Policy Agenda and 2003 Annual Report*, Mar. 2004, p. 164.

¹¹² U.S. Department of State telegram, "China IPR: Year 2004 Special 301 Review," message reference No. 3185, prepared by U.S. Embassy, Beijing, Feb. 25, 2004.

Taiwan

In 2003, Taiwan was the 8th largest U.S. trading partner with bilateral trade totaling more than \$47.6 billion, representing a decline of 2.5 percent from \$48.8 billion in 2002. The U.S. trade deficit with Taiwan increased by less than 1 percent in 2003 from approximately \$15.3 billion to nearly \$15.4 billion. U.S. exports to Taiwan declined by 4 percent to \$16.1 billion in 2003 from approximately \$16.8 billion in 2002. Leading U.S. exports to Taiwan consisted of electronic integrated circuits and other electrical machinery and equipment, aircraft and parts, corn, soybeans, computer equipment, and munitions. U.S. imports from Taiwan declined by 1.8 percent to approximately \$31.5 billion in 2003 from \$32.1 billion in 2002. Leading U.S. imports from Taiwan consisted of computers and parts, electronic monolithic integrated circuits, and magnetic media. U.S.-Taiwan trade data are shown in appendix tables A-31 through A-33.

Intellectual Property Rights Protection

During 2003, Taiwan continued to make significant progress in a number of IPR areas, especially in IPR-related enforcement actions. An Integrated Enforcement Task Force (IETF) was created during 2003 to join forces with the Joint Optical Disk Enforcement Tasks Force (JODE) to crack down on optical disc media piracy.¹¹³ JODE inspected over 1,000 factories during the year and IETF made between 300-400 inspections per month. Taiwan's enforcement authorities, in cooperation with Microsoft, also conducted raids that led to arrests against criminal syndicates suspected of producing, marketing, and distributing counterfeit software. Taiwan's Intellectual Property Office has proposed a registration system to simplify power of attorney requirements in Taiwan. However, piracy remains high and Taiwan remained on USTR's Priority Watch List for problems associated with protecting intellectual property rights in 2003. Even though the legislative Yuan passed an amendment to the copyright law that made intellectual property violations a public crime, Taiwan still lacks an effective copyright law.¹¹⁴

Korea

U.S. two-way trade with Korea totaled more than \$59 billion in 2003. U.S. exports to Korea grew 6.5 percent to \$22.5 billion in 2003, after rising 1.2 percent in 2002. U.S. imports grew 4.7 percent to \$36.9 billion, after rising 1.0 percent in 2002. The United States recorded a \$14.4 billion trade deficit with Korea in 2003. Leading U.S. exports

¹¹³ U.S. Department of State, "Taiwan Special 301 Review: AIT Submission," message reference No. 533, prepared by AIT, Taipei, Feb. 24, 2004.

¹¹⁴ U.S. Department of State, "Taiwan: Small Steps on IPR Enforcement," message reference No. 2839, prepared by AIT, Taipei, Oct. 1, 2003.

to Korea in 2003 included computer chips, aircraft, machines and mechanical appliances having individual functions (mostly semiconductor production machinery), and aircraft parts. Leading U.S. imports from Korea include transmission apparatus incorporating reception apparatus (mostly cellular phones), automobiles, and computer chips. U.S.-Korea trade data are shown in appendix tables A-34 through A-36.

U.S.-Korean trade relations in 2003, reflected the continued relaxation of trade frictions in recent years. The two countries meet regularly to discuss bilateral trade issues. Significant bilateral trade issues between the United States and Korea during 2003 included IPR protection and telecommunications.

Intellectual Property Rights Protection

USTR placed Korea on the Special 301 Priority Watch list in 2000, citing a number of long-standing intellectual property rights (IPR) issues, concerns about enforcement, and recent amendments to IPR legislation.¹¹⁵ Based on commitments made in trade meetings between the United States and Korea in April 2002, Korea was downgraded to the Watch List in 2002.¹¹⁶

In the 2003 Special 301 Report,¹¹⁷ USTR said that the limited steps that Korea had taken to fulfill its 2002 commitments fell short of what Korea had pledged to do and that new and significant IPR issues had emerged. For these reasons, USTR decided to conduct an out-of-cycle Special 301 Review in the fall of 2003. The decision to keep Korea on the Watch List or move it the Priority Watch List was to be based on Korea's taking action in all of the following areas:

1. Take all actions necessary to ensure that the Standing Inspection Team (SIT) is granted police powers at the earliest opportunity;
2. Draft and submit legislation to the National Assembly that establishes the exclusive right of transmission for sound recordings, including both the full right of making available and the full right of communication to the public, and seek its enactment by the end of 2003; and
3. Provide additional, new data on the Republic Of Korea Government's (ROKG's) enforcement efforts that is sufficient to more fully evaluate the full range of its enforcement activities, including the imposition of deterrent penalties, that are sufficient to allow right holders the opportunity to take action against infringers who are not convicted.

¹¹⁵ USTR, *2000 Special 301 Report*, May 1, 2000, p. 17.

¹¹⁶ USTR, *2003 Trade Policy Agenda and 2002 Annual Report of the President of the United States on the Trade Agreements Program*, Mar. 3, 2003, p. 175.

¹¹⁷ USTR, *2003 Special 301 Report*, May 1, 2003, p. 24.

4. In addition, in order to resolve the film distribution issues, the Government of Korea should draft and submit legislation to the National Assembly to grant the Korea Media Review Board (KMRB) all authority necessary to stop film piracy. This legislation and/or the implementing regulations must:
 - a. clearly provide the KMRB the authority to reject false applications,
 - b. clearly provide the KMRB the authority to cancel existing ratings that were approved on the basis of a false application, and
 - c. not place undue burdens on legitimate rights holders to prove their rightful ownership;
5. Fully and faithfully implement its agreement on the Wireless Broadband Internet Platform for Interoperability (WIPI) intellectual property issue.¹¹⁸

At the end of 2003, progress had been made on a number of issues broached in the 2003 Special 301 Report, while less progress had been made on others. In July 2003, the Korean National Assembly passed legislation to give police powers to the SIT of the Ministry of Information and Communication, with the new authority taking effect on October 18, 2003. The United States continues to be concerned, however, about the transparency of the SIT enforcement process.¹¹⁹ Legislation to amend Korea's Copyright Act to give exclusive rights for the on-line dissemination of recorded music had not been passed at year-end, and the United States is concerned that proposed legislation will not provide a full set of exclusive rights that will stem on-line piracy.¹²⁰ During 2003, the Korean Government provided regular quarterly reports on enforcement activities, but did not provided new data by which the effectiveness of its enforcement efforts could be better evaluated.¹²¹ In December 2003, legislation was passed that the Korean Government grants the KMRB authority to identify and stop the fraudulent registration of videos, DVDs, and games. The U.S. Government expressed concern that draft implementing regulations might place undue burdens on legitimate rights holders to prove their rightful ownership. However, the KMRB has committed to redrafting the regulations to address U.S. concerns.¹²² Developments related to the WIPI telecommunications standard are addressed below.

Telecommunications

The United States has expressed ongoing concerns that Korea intends to mandate telecommunications technology standards in Korea rather than allow market forces to

¹¹⁸ Ibid, p. 25.

¹¹⁹ USTR, *2004 National Trade Estimate Report on Foreign Trade Barriers*, Apr. 1, 2004, p. 300.

¹²⁰ Ibid, p. 301.

¹²¹ Ibid, p. 300.

¹²² Ibid, p. 301.

determine successful technologies.¹²³ Three key areas have been the focus of U.S.-Korea dialogue in this area. The first relates to the wireless broadband Internet platform for interoperability (WIPI) for cellular phones. Although currently several platforms are in operation in Korea, including one provided by an American company, the United States is concerned that there is inappropriate Korean Government involvement in the creation, standardization, and deployment of WIPI.¹²⁴ The Korean Government has delayed mandating WIPI in response to U.S. concerns, and continues to consult with the United States and WTO bodies.¹²⁵ The other two areas of concern relate to reallocation of the 2.3 gigahertz spectrum and to location-based services (LBS).¹²⁶

One of the problems identified with the proposed WIPI standard was its use of the intellectual property of a U.S. company without that company's permission.¹²⁷ An agreement was reached between that company and the WIPI developers during 2003.¹²⁸

Brazil

U.S.-Brazilian bilateral trade relations continue to be influenced by Brazil's membership in the Southern Common Market (Mercosur) customs union,¹²⁹ and by ongoing negotiations for the Free Trade Area of the Americas (FTAA).¹³⁰ Brazil ranked as the sixteenth largest export market for the United States in 2003, and was the thirteenth largest U.S. supplier in the year. U.S. exports to Brazil totaled \$9.9 billion in 2003, while U.S. imports from Brazil totaled \$17.7 billion. Leading U.S. exports to Brazil in 2003 included aircraft, and aircraft parts and computer parts and accessories. Leading U.S. imports from Brazil included aircraft, electronic articles, petroleum, and footwear. U.S.-Brazilian trade data are shown in appendix tables A-37 to A-39.

¹²³ See, for example, U.S. Department of State telegram, "Failing to Connect on the Cutting Edge: U.S.-Korean Experts Telecom Dialogue Makes Little Headway," message reference No. 316239, prepared by U.S. Department of State, Washington, D.C., Nov. 13, 2003; USTR, *2004 Trade Policy Agenda and 2003 Annual Report of the President of the United States on the Trade Agreements Program*, March 1, 2004, pp. 150-51; and U.S. Department of State telegram, "U.S. Ambassador Discusses WIPI, IPR, and Nortel with New Telecom Minister," message reference No. 2107, prepared by U.S. Embassy, Seoul, Apr. 30, 2003.

¹²⁴ USTR, *2004 Trade Policy Agenda and 2003 Annual Report of the President of the United States on the Trade Agreements Program*, Mar. 1, 2004, p. 151.

¹²⁵ USTR, *2004 National Trade Estimate Report on Foreign Trade Barriers*, Apr. 1, 2004, p. 317.

¹²⁶ USTR, *2004 Trade Policy Agenda and 2003 Annual Report of the President of the United States on the Trade Agreements Program*, Mar. 1, 2004, p. 151.

¹²⁷ See, for example, U.S. Department of State telegram, "U.S.-Korea Trade Consultations: Telecom," message reference No. 55701, prepared by U.S. Department of State, Washington, D.C., Mar. 4, 2003.

¹²⁸ U.S. Department of State telegram, "June 2003 U.S.-Korea Trade Consultations: Telecom," message reference No. 211677, prepared by U.S. Department of State, Washington, D.C., July 22, 2003.

¹²⁹ The Mercosur customs union is a free trade area with common external tariffs. Members of the Mercosur customs union are Argentina, Brazil, Paraguay, and Uruguay. Bolivia, Chile, and Peru participate in the Mercosur free trade area, but not in the common external tariff scheme. Mercosur became operative on Jan. 1, 1995.

¹³⁰ The FTAA is discussed in more detail in chapter 4.

Brazil's approval process for biotechnology imports has been a trade problem for several years.¹³¹ Regulation of the biotechnology sector remains essentially frozen because of a 1998 court case that remains pending in a Brazilian federal court. In the absence of a definitive court ruling on this case, Brazilian President Lula made progress in 2003 towards a new legal framework for production and marketing of biotechnology soybean crops. Law 10,814, which was enacted on December 15, 2003, legalizes the planting and marketing of biotechnology soybean crops for the 2003/2004 harvest.¹³²

Another long-standing bilateral trade problem involves the protection of intellectual property rights (IPR) in Brazil. Brazil is on the U.S. Special 301 Priority Watch List due to continuing concerns about copyright and trademark infringement, inadequate IPR enforcement, and the need to improve its processing of patent applications in a manner that is consistent with its international obligations.¹³³ To address some of these concerns during 2003, Brazil doubled the minimum penalty for copyright violations, launched a national public awareness campaign, and began IPR training at the national police academy.¹³⁴

¹³¹ The lack of a clear policy on biotechnology in Brazil reportedly has resulted in U.S. companies losing several opportunities to sell biotechnology products to Brazil. Although the Brazilian Government approved imports of Roundup Ready soybeans from the United States in 1998, that approval has been challenged and the issue remains in the Brazilian legal system pending resolution. For further information, see USITC, *The Year in Trade, 2000*, USITC Publication 3428, p. 4-49.

¹³² USTR, *2004 National Trade Estimate Report on Foreign Trade Barriers*, "Brazil," found at <http://www.ustr.gov/reports/nte/2004/brazil.pdf>, retrieved Apr. 5, 2004.

¹³³ Ibid. The "special 301" law is discussed in chapter 2.

¹³⁴ Ibid.

